

## **PUBLIC HEARING DRAFT**

# COMPREHENSIVE FISCAL ANALYSIS AND PLAN FOR SERVICE FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN

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EPS #17060

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# I. INTRODUCTION

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This report presents a Comprehensive Fiscal Analysis (CFA) of the incorporation of San Martin. The requirement for the CFA is established in the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (California Government Code Section 56000 et seq.) at Section 56800 (herein the “Statute”).

The current CFA includes changes and revisions to an earlier draft report (March 5, 2008). The revisions are the result of ongoing review and comment by LAFCO, the County, the Proponents, and members of the public. This report also includes terms required to achieve revenue neutrality.

As currently proposed, the proposal would incorporate the San Martin community within Santa Clara County, nestled between the City of Morgan Hill to the north and the City of Gilroy to the south. Highway 101 runs through the proposed boundaries with an interchange at San Martin Avenue, providing access to San Martin’s primary commercial area. San Martin is composed predominantly of large-lot, single-family residential units and an older commercial core.

**Figure 1** depicts the proposed incorporation boundary; **Figure 2** shows potential boundary modifications. The area is home to approximately 6,900 residents and includes the CordeValle Resort and Golf Club and Clos LaChance Winery in the western portion of the City. These boundaries will be evaluated and may be refined by LAFCO during its public hearing process.

This CFA provides LAFCO with information necessary to make the determinations required by the State statutes. LAFCO has the authority to approve, deny, or modify the incorporation proposal and must in all cases impose specific terms and conditions regarding the transition of governance to a municipality. If LAFCO approves the proposal, an election would be held. Majority voter approval is required to create the incorporated City of San Martin.

Financial feasibility is a key finding that must be made by LAFCO; however, LAFCO itself is instrumental in determining financial feasibility since it imposes conditions that directly affect costs and revenues accruing to the new City. These conditions include:

- Timing of incorporation (date of the election and the effective date of the new City).
- Boundaries of the new City.
- Property tax transfer.
- Mitigation terms and conditions related to “revenue neutrality.”
- Related governmental boundary changes, such as dissolutions of or detachments from special districts.

## **METHODOLOGY AND KEY ASSUMPTIONS**

This CFA has been prepared in cooperation with Santa Clara County and other local service providers. The CFA includes a municipal budget model and forecast. Revenue estimates are based on specific mandated formulas (property tax), the development schedule (sales tax), and estimates of population growth (motor vehicle license fees [VLF]). Costs estimates are based on potential increases in the population, as well as on the anticipated City staff required to provide services to the new City. Staffing and expenditure levels are based on current County expenditures, as well as a review of other small cities. The analysis follows guidelines established by State law and as described by the State Office of Planning and Research (OPR) Guidelines (2003), as well as LAFCO policies applicable to CFAs.

The analysis evaluates the feasibility of a new City, taking into account land use development trends, the proposed municipal government structure, and a projection of municipal costs and revenues. The analysis also evaluates the potential impacts of incorporation upon agencies presently providing services to San Martin (e.g., Santa Clara County).

Cost information uses the most recent fiscal year, which is the 2006-07 fiscal year (FY 07). Additional information and adjustments have been made as necessary for the budget forecast for the new City to reflect the future manner of service provision as well as cost increases. The CFA uses conservative assumptions; city feasibility does not depend upon assumptions about future revenue growth. Service levels are assumed to be maintained at current levels, unless otherwise noted. The analysis adheres to OPR Guidelines which state: "In general, the new City's level of expenditures will be based on the cost of transferred services currently provided by the county and other local agencies." Santa Clara LAFCO guidelines also indicate: "Costs of services in the proposal area shall be based on existing levels of service provided in the proposal area by the County and other agencies during the base year" (Policy 9.d.).

While actual future budget costs may be lower than projected in this CFA, LAFCO policies dictate a conservative approach to the projections in order to minimize the future risk of reduced or inadequate service levels. To the extent that the City's actual costs are lower than projected because of improved efficiencies or other factors, additional revenues could be available for other purposes such as contingencies and reserves, capital improvements, and public facilities or for improvement of service levels.

## II. FINDINGS

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The following findings are based on research and analysis conducted to date, as well as on review and comment provided by County staff, LAFCO staff, the public and the Proponents.

1. *San Martin can generate revenues sufficient to cover expenditures, and revenue neutrality mitigation payments contingent on approval of a utility users tax as described in this report.*

The summary of projected annual City costs and revenues shown in **Table 1** indicates that the new City can generate sufficient General Fund revenues to cover General Fund costs and establish adequate reserves, assuming approval of a tax measure. Without approval of a tax measure, there would be an annual budget shortfall of approximately \$500,000 during the initial six years; in subsequent years the shortfall is estimated to be \$375,000 annually. As shown in **Table 1**, there is the potential for a minimal General Fund shortfall in the initial Transition Year of \$63,000; however, this shortfall can be eliminated by repaying portions of the County's Transition Year service costs over a five year period, as allowed by State law. In future years there are anticipated to be slight surpluses that can be used to help fund road maintenance or other public facilities and services.

**Table 1** includes a revenue neutrality payment from the City to the County to mitigate impacts on the County General Fund of \$870,000. The amount of the payments are based on annual impacts for a ten-year period, with re-payment spread over 25 years with an inflation factor, thus reducing the annual required payment to \$500,771.

The resulting annual payment of \$500,771 creates a budget shortfall that requires additional tax revenue for the City to be feasible. The additional taxes are new taxes (assumed to be a utility users tax) not currently collected by the County. During the initial six years of the new City, minimal net revenues are available. In the initial years, it is expected that the full amount of the payment will be required to be collected from the additional taxes; this represents an approximate annual burden of \$238 per residential unit, or a 10 percent utility users tax against gas and electric consumption. The amount of tax required is likely to be less following year 6, when the new City is able to contribute approximately \$180,000 or more annually towards the mitigation obligation. After the sixth year, the average burden per residential unit is approximately \$153 annually, or 6.4 percent of a \$200 per month utility bill.

The projections in **Table 1** assume that the effective date is July 1, 2009 or soon thereafter. This effective date requires that the election occur in June 2009. This date allows up to twelve months during which the County is required by State law to continue providing services; the cost of these services is to be subsequently repaid by the City. The new City will not accrue substantial revenues until later in the fiscal year and into the following fiscal year, when the property tax rolls become effective and sales tax checks are distributed by the State to the new City. State law provides that revenues generated within the area following incorporation shall be applied towards the County's

**INCLUDES REVENUE NEUTRALITY MITIGATION**

**Table 1**

**Summary of Revenues and Expenses (All Figures in Constant \$'s)**

**San Martin Incorporation Analysis, EPS #17060**

**Full Transition Year**

**12 months**

**Proponents' Proposed Boundary**

Item	Fiscal Year									
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	1	2	3	4	5	6	7	8	9	10
<b><u>A. GENERAL FUND OPERATIONS</u></b>										
<b>General Fund Revenues</b>										
Property Taxes	\$0	\$705,773	\$724,107	\$742,968	\$762,367	\$782,320	\$802,841	\$823,945	\$845,646	\$867,960
Sales Tax	\$419,443	\$838,885	\$838,885	\$838,885	\$838,885	\$838,885	\$838,885	\$838,885	\$838,885	\$838,885
Transient Occupancy Tax	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557	\$221,557
Real Property Transfer Tax	\$5,305	\$5,436	\$5,571	\$5,708	\$5,849	\$5,993	\$6,141	\$6,292	\$6,447	\$6,605
Franchise Fees	\$289,670	\$289,873	\$290,075	\$290,277	\$290,479	\$290,681	\$290,883	\$291,086	\$291,288	\$291,490
Planning and Building Fees	\$0	\$274,742	\$276,116	\$277,496	\$278,884	\$280,278	\$281,679	\$283,088	\$284,503	\$285,926
Public Works/Eng. Fees	\$0	\$89,020	\$89,465	\$89,913	\$90,362	\$90,814	\$91,268	\$91,724	\$92,183	\$92,644
Fines, Penalties, Misc.	\$42,813	\$32,684	\$32,793	\$32,901	\$33,009	\$33,117	\$33,225	\$33,333	\$33,441	\$33,549
State Motor Vehicle License Fees	\$62,172	\$62,377	\$62,583	\$62,788	\$62,994	\$63,200	\$63,405	\$63,611	\$63,816	\$64,022
Utility Users Tax (1)	\$499,800	\$499,800	\$499,800	\$499,800	\$499,800	\$499,800	\$321,300	\$321,300	\$321,300	\$321,300
VLF (AB1602)	\$547,312	\$512,513	\$477,474	\$442,193	\$406,670	\$370,907	\$372,113	\$373,320	\$374,526	\$375,733
Revenue Credits (transition yr, rec'd by County)	revenues retained by County during Transition Year are credited to city repayment for Transition Year services.									
Investment Earnings	\$41,761	\$70,653	\$70,369	\$70,090	\$69,817	\$69,551	\$66,466	\$66,963	\$67,472	\$67,993
<b>Total</b>	<b>\$2,129,834</b>	<b>\$3,603,315</b>	<b>\$3,588,794</b>	<b>\$3,574,576</b>	<b>\$3,560,674</b>	<b>\$3,547,104</b>	<b>\$3,389,765</b>	<b>\$3,415,103</b>	<b>\$3,441,065</b>	<b>\$3,467,665</b>
<b>General Fund Expenses</b>										
Legislative	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500	\$29,500
Elections	\$200,000	\$10,000	\$0	\$10,000	\$0	\$10,000	\$0	\$10,000	\$0	\$10,000
City Manager and City Clerk	\$281,225	\$328,659	\$330,289	\$331,927	\$333,573	\$335,227	\$336,890	\$338,561	\$340,240	\$341,928
City Attorney	\$250,000	\$76,131	\$76,511	\$76,894	\$77,278	\$77,665	\$78,053	\$78,443	\$78,836	\$79,230
Administrative Services	\$166,050	\$222,507	\$223,620	\$224,738	\$225,861	\$226,991	\$228,126	\$229,266	\$230,413	\$231,565
Police	\$0	\$588,661	\$594,598	\$600,594	\$606,650	\$612,767	\$618,944	\$625,184	\$631,485	\$637,850
Animal Control	\$0	\$74,811	\$75,185	\$75,561	\$75,939	\$76,319	\$76,700	\$77,084	\$77,469	\$77,856
Planning and Building	\$137,672	\$443,032	\$444,635	\$446,246	\$347,864	\$349,491	\$351,126	\$352,769	\$354,421	\$356,080
Public Works Administration	\$74,250	\$178,040	\$178,931	\$179,825	\$180,724	\$181,628	\$182,536	\$183,449	\$184,366	\$185,288
Revenue Neutrality Mitigation Payment (1)	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771	\$500,771
Non-Departmental										
Office Rent/Supplies	\$109,000	\$112,500	\$84,500	\$76,500	\$76,500	\$76,500	\$76,500	\$76,500	\$76,500	\$76,500
Insurance	\$37,431	\$61,915	\$61,133	\$61,554	\$58,617	\$59,283	\$59,351	\$60,023	\$60,097	\$60,774
Contingency (10%)	\$233,596	\$212,576	\$209,890	\$211,334	\$201,251	\$203,537	\$203,773	\$206,078	\$206,333	\$208,657
Reserve Fund Contribution	\$233,596	(\$21,020)	(\$2,686)	\$1,444	(\$10,083)	\$2,286	\$236	\$2,305	\$255	\$2,324
LAFCO	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437	\$1,437
Repayment of Transition Yr Cnty Services (2)	(\$61,566)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>Total</b>	<b>\$2,192,960</b>	<b>\$2,819,521</b>	<b>\$2,808,314</b>	<b>\$2,828,323</b>	<b>\$2,705,882</b>	<b>\$2,743,400</b>	<b>\$2,743,943</b>	<b>\$2,771,369</b>	<b>\$2,772,122</b>	<b>\$2,799,760</b>
<b>General Fund Operating Surplus (Deficit) (3)</b>	<b>(\$63,127)</b>	<b>\$783,794</b>	<b>\$780,480</b>	<b>\$746,253</b>	<b>\$854,792</b>	<b>\$803,703</b>	<b>\$645,822</b>	<b>\$643,734</b>	<b>\$668,943</b>	<b>\$667,905</b>
<b>Reserve Fund Balance</b>	<b>\$233,596</b>	<b>\$212,576</b>	<b>\$209,890</b>	<b>\$211,334</b>	<b>\$201,251</b>	<b>\$203,537</b>	<b>\$203,773</b>	<b>\$206,078</b>	<b>\$206,333</b>	<b>\$208,657</b>
% of Expenditures (exc. conting, reserves, mitigatio	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
<b><u>B. ROAD FUND OPERATIONS</u></b>										
<b>Road Fund Revenues</b>										
Gas Taxes	\$200,789	\$188,455	\$176,036	\$163,531	\$150,940	\$138,264	\$138,692	\$139,119	\$139,547	\$139,975
Prop 42 Funds	\$63,687	\$63,899	\$64,751	\$65,614	\$66,488	\$67,373	\$68,268	\$69,175	\$70,094	\$71,023
<b>Total</b>	<b>\$264,476</b>	<b>\$252,354</b>	<b>\$240,787</b>	<b>\$229,145</b>	<b>\$217,428</b>	<b>\$205,637</b>	<b>\$206,960</b>	<b>\$208,295</b>	<b>\$209,641</b>	<b>\$210,998</b>
<b>Road Fund Expenditures</b>										
Pavement Maintenance		\$310,050	\$313,150	\$316,282	\$319,445	\$322,639	\$325,865	\$329,124	\$332,415	\$335,740
Signal Maintenance, Traffic Engineering		\$51,008	\$51,263	\$51,519	\$51,776	\$52,035	\$52,296	\$52,557	\$52,820	\$53,084
Other Costs (sweeping, trash removal, signs, drainage)		\$370,644	\$372,497	\$374,360	\$376,232	\$378,113	\$380,003	\$381,903	\$383,813	\$385,732
Contingency (10%)		\$73,170	\$73,691	\$74,216	\$74,745	\$75,279	\$75,816	\$76,358	\$76,905	\$77,456
Repayment of Transition Yr Cnty Services	\$0	\$180,928	\$180,928	\$180,928	\$180,928	\$180,928				
<b>Total</b>	<b>\$0</b>	<b>\$985,800</b>	<b>\$991,529</b>	<b>\$997,304</b>	<b>\$1,003,126</b>	<b>\$1,008,994</b>	<b>\$833,981</b>	<b>\$839,943</b>	<b>\$845,953</b>	<b>\$852,011</b>
<b>Road Fund Operating Surplus (Deficit)</b>	<b>\$264,476</b>	<b>(\$733,446)</b>	<b>(\$750,742)</b>	<b>(\$768,160)</b>	<b>(\$785,698)</b>	<b>(\$803,357)</b>	<b>(\$627,021)</b>	<b>(\$631,648)</b>	<b>(\$636,312)</b>	<b>(\$641,013)</b>
<b>TOTAL, All Funds</b>	<b>\$201,350</b>	<b>\$50,348</b>	<b>\$29,738</b>	<b>(\$21,907)</b>	<b>\$69,094</b>	<b>\$346</b>	<b>\$18,802</b>	<b>\$12,086</b>	<b>\$32,631</b>	<b>\$26,892</b>
<b>Cumulative Surplus (Deficit)</b>	<b>\$201,350</b>	<b>\$251,698</b>	<b>\$281,436</b>	<b>\$259,529</b>	<b>\$328,622</b>	<b>\$328,969</b>	<b>\$347,770</b>	<b>\$359,856</b>	<b>\$392,487</b>	<b>\$419,379</b>

(1) New utility users tax included to offset payment for impacts on County General Fund. Amount reduced in Year 7 when City is able to contribute other net revenues to repayment.

(2) Repayment for animal services, planning and land use, code enforcement, public works, and sheriff services the County is obligated to provide for the remainder of the first fiscal year (less County-retained revenues).

(3) Potential initial year shortfall can be spread over subsequent years by deferring repayment of County's Transition Year service costs; this will not affect the fiscal conclusions.



costs to serve the area during the transition period.<sup>1</sup> The revenues are shown in **Table 1** as a “credit.” However, the credit exceeds the cost of County transition-year services; the difference is assumed to be transferred to the City and/or credited against the revenue neutrality obligation, in accordance with LAFCO Terms and Conditions.

If the effective date is after July 1, 2009, the new City would receive nearly a full year of County services while beginning to accrue property taxes, sales taxes, and other revenues. Although the Transition Year costs and revenues would be less than shown in **Table 1**, the difference would not significantly change the financial conclusions in this analysis.

This analysis demonstrates that most service levels can be maintained at a level equal to or greater than current services. However, residents (with the exception of law enforcement personnel) will no longer have access to certain services of the County animal control shelter.

## ***2. Road maintenance will require the use of General Fund revenues.***

Similar to most small cities in California, San Martin would have difficulty funding required levels of road maintenance because of limited revenues. This situation is exacerbated by the relatively high number of rural roads (approximately 55 miles) in San Martin compared to its population and revenue base. The City also would not have access in the near term to redevelopment revenues (due to the time required to create a redevelopment area), and impact fee revenues would be minimal due to the small amount of future new development anticipated consistent with maintaining the rural character of the area as envisioned by the Proponents.

If the County transfers the roads to the City in a condition that meets County standards for rural roads, required future maintenance expenditures will be lower than the \$1.5 million expended by the County in the San Martin area in FY 07. Because the roads are assumed to be transferred in a condition equal to or exceeding County standards for rural roads,<sup>2</sup> the City should not need to continue the same level of expenditures as the County in recent years. The budget forecast assumes an ongoing level of routine maintenance which should be sufficient to maintain the roads at the rural standard.

In addition to pavement maintenance, the City will be responsible for other types of continuing maintenance, including drainage maintenance, street sweeping, tree trimming, trash removal, weed control, and related services. The CFA uses costs for services currently provided by the County. A review of comparable small cities indicates that many cities spend less on similar services; this can be attributable to either

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<sup>1</sup> Cortese-Knox-Hertzberg Local Reorganization Act of 2000, Sec. 57384. Because of the timing of the effective date, certain revenues (e.g., property tax) generated from the incorporation area will continue to be distributed to the County until the new City submits required documentation to the State.

<sup>2</sup> The County’s standard for pavement condition on rural roads is a Pavement Condition Index (PCI) of 70 out of a maximum of 100.

a lower revenue base, the use of funding from assessment districts that take responsibility for funding of services through assessments, or a different or reduced mix of services because of geographic conditions and resident preferences.

However, the new City's annual road-related expenditures of approximately \$805,000 (excluding County repayment) are still substantially greater than City Road Fund revenues (primarily gas taxes) of \$250,000 (in the first full year). To maintain roads at a level similar to current standards, the City will need to transfer funds from its General Fund to the Road Fund. As shown in **Table 1**, the City's General Fund surpluses should be sufficient to fund the road-related expenditures.

***3. The incorporation will have an adverse impact on the County's General Fund of approximately \$870,000 annually and will require a payment from the City to the County.***

County revenue reductions exceed expenditures for service responsibilities transferred to the new City by approximately \$870,000 annually, indicating a "revenue neutrality" imbalance and potential negative impact upon the County that must be mitigated, according to State law. **Table 3** in this report summarizes potential changes in County service responsibilities and reductions in revenues. The changes are based on FY07 and reflect County service provision. These numbers differ from the forecasts of City services and revenues shown in **Table 1** because certain City revenues (e.g., gas taxes) are allocated on a different basis than the County's revenues, and many of the services will be provided in a different manner. For example, the new City will not provide an animal shelter, as currently provided by the County, and other city staffing and services will be contracted or staffed differently than current County services.

The amount of revenue neutrality mitigation payments from the City to the County are based on annual impacts for a ten year period, with re-payment spread over 25 years as described in Finding 1 above.<sup>3</sup>

Repayment to the County for transition-year General Fund services is shown at the end of the initial year; however, this payment may be spread over the subsequent five years if necessary to help assure adequate fund balances are established. Spreading the costs will be at the discretion of the future city council, and will be based on anticipated revenues and fund balances at that time; the spreading of the repayment will help the City manage its cash flow in the early years, but is not otherwise expected to significantly alter the financial conclusions in this report.

***4. The incorporation will have a positive impact on the County's Road Fund.***

The County will transfer its responsibility for road maintenance to the new City, with minimal impact on funding sources dedicated to road maintenance. The net benefit is nearly \$1.5 million. The County has indicated that this amount does not necessarily

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<sup>3</sup> The mitigation to the payment includes an inflation factor of 3 percent annually.

represent a typical year because of extraordinary expenditures, but rather the average benefit would be \$800,000 to \$950,000 annually.

**5. *Other agencies and districts will not be significantly affected by incorporation.***

The incorporation will require that South County Fire become responsible for areas previously designated as State Responsibility Areas (SRAs). South County Fire indicates that its annual costs and revenues will not be adversely affected

**6. *The Effective Date of incorporation will affect City finances.***

The CFA assumes a full transition year during which the County is required to continue to provide services; repayment is assumed to occur at the end of the year for General Fund services only. Repayment of Road Fund transition year services is assumed to be spread over multiple years to help manage the city's cash flow.

In accordance with State law, the revenues generated within the incorporation area during the transition year will be credited towards the County's transition-year services during that time. To the extent that the credited revenues exceed the repayment amount to the County, it will be necessary for the remaining credit to apply towards the revenue neutrality mitigation, or be transferred by the County directly to the City.

**Table 1** illustrates projected annual city costs and revenues assuming a 12-month transition period, enabling the new City to accrue additional revenues to build reserves. If the effective date of the City is after July 1, 2009 the County will provide services for the remainder of the fiscal year, and the City's repayment for Transition Year County services will be lower. This difference is not anticipated to have a material impact on the financial conclusions.

**7. *Potential boundary options may reduce Road Fund shortfalls and required General Fund transfers.***

LAFCO is required to evaluate potential boundary options.<sup>4</sup> Options evaluated by LAFCO were generally less densely developed by comparison to the Proponents' proposed boundary and with more road miles relative to population (see **Figure 2**). Further analysis of the impacts of the boundaries on the City's budget was conducted of two major options to the northern and southern boundaries. (The three boundary alternatives evaluated in previous versions of this CFA are included in Appendices II, III, and IV, and consist of exclusion of Area 4, exclusion of Area 5, and exclusion of both Areas 4 and 5.) At its February 2008 LAFCO meeting, the Commission provided preliminary direction on proposed boundaries to exclude Areas 1 and 6 and to include Areas 2 and 3, 4, 5 and 7. The current CFA revisions focus on the recommended

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<sup>4</sup> LAFCO staff report, December 5, 2007.

boundary which for fiscal analysis purposes is similar to that submitted by the Proponents. However, the conclusions of the prior analysis of boundary options are not significantly changed by subsequent revisions to the CFA.

Analysis of the boundary options concluded there would be a positive impact on the City's Road Fund because of reductions in road miles and road-related costs, which are proportionately greater than the reductions in population and per-capita gas tax revenues. However, the net to the General Fund was reduced by an amount greater than the City's Road Fund savings because of reductions in revenues that were not offset by cost savings.

The boundary alternatives do not significantly change the impact on the County General Fund. The benefit to the County Road Fund is lower as a result of the transfer of fewer road miles and, consequently, less savings in road maintenance costs.

### III. THE INCORPORATION PROPOSAL

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The following sections describe basic characteristics of the San Martin municipal government as described in the Petition of Incorporation of the Town of San Martin and as assumed in this CFA. Actual Terms and Conditions will be prepared by LAFCO in advance of the Public Hearing on the incorporation proposal which may modify and augment the preliminary terms described below.

#### NAME OF THE NEW CITY

The name of the new City shall be the Town of San Martin.

#### FORM OF GOVERNMENT

San Martin will be incorporated as a General Law city under the Constitution of the State of California. The proposed form of the new City would be the “Council/Manager” form common to small and mid-sized cities throughout the State. Under the Council/Manager form, a five-person City Council, elected at-large, would retain a City Manager who would be responsible for the day-to-day operations of the City with an appointed City Clerk.

#### CITY BOUNDARY

**Figure 1** depicts the preliminary municipal boundary proposed by the Proponents with changes as directed by LAFCO at its February 2008 meeting for the Town of San Martin. This boundary option includes residential uses, the existing commercial district, the CordeValle Resort and Golf Club, and the Clos LaChance Winery.

#### REORGANIZATION

The proposed incorporation does not include any special district reorganization. Pursuant to Government Code 25210.90, CSAs will be automatically detached upon incorporation unless LAFCO can make certain findings to waive the detachment. It is assumed for the purposes of this report that the County Lighting Service Area will continue to provide service and the area will be automatically detached from the County Library Services District.

## **SERVICE LEVELS**

This CFA presumes and reflects municipal expenditures that maintain existing municipal service levels. Potential exceptions and proposed service levels are discussed in **Chapter V**.

## **EFFECTIVE DATE**

The summary of projected annual city costs and revenues shown in **Table 1** assumes that the effective date is July 1, 2009. This date allows twelve months during which the County is required by State law to continue providing services, to be subsequently reimbursed by the City (as requested by the County).

## **GANN LIMIT**

Local agencies in California that receive proceeds of taxes are required to have a limit on how much tax money they can spend. It is called the Gann Limit. Under State law, the LAFCO resolution of approval and the ballot question before the voters must identify a provisional Gann Limit. Following incorporation, the City Council will place a permanent Gann Limit on a future ballot for voter approval. The CFA indicates that a Gann limit of \$3.8 million should be established for the new City. This is based on the estimated proceeds of taxes (including utility users tax revenues) received during the first year following the Transition Year, and includes an inflation factor.<sup>5</sup>

## **NEW TAXES**

As described in the Summary of Findings, new taxes will be required in order for the City to fund all expenditures, including an annual payment to the County to mitigate fiscal impacts on the County General Fund because of the incorporation.

The amount of the payments from the City to the County is based on annual impacts for a ten-year period, with re-payment spread over 25 years.<sup>6</sup> The resulting annual payment of \$500,771 is shown to require additional tax revenue for the City to be feasible and able to fully fund total City expenditures including the County payment. The additional taxes are new taxes (assumed to be a utility users tax) not currently collected by the County. During the initial six years of the new City, minimal net revenues are available. In the initial years, it is expected that the full amount of the

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<sup>5</sup> The proceeds of taxes shown in **Table 1** are inflated by 3 percent annually for a four-year period to allow for potential revenue growth caused by inflation. After the City is formed, the Gann limit will be adjusted annually based on population growth and inflation, unless and until the voters approve a new limit.

<sup>6</sup> The mitigation to the payment includes an inflation factor of 3 percent annually.

payment will be required to be collected from the additional taxes; this represents an approximate annual burden of \$238 per residential unit, or a 10 percent utility users tax against gas and electric consumption. The amount of tax required is likely to be less following year 6, when the new City is able to contribute approximately \$180,000 or more annually towards the mitigation obligation. After the sixth year, the average burden per residential unit is approximately \$153 annually, or 6.4 percent of a \$200 per month utility bill.

A utility users tax is recommended, rather than a parcel tax, because a majority vote is required. A parcel tax would require a two-thirds majority voter approval.

## **CAPITAL IMPROVEMENTS**

As a rural community, San Martin has limited urban infrastructure (e.g., public water and sewer systems, etc.). It is assumed that this will not change following incorporation. Thus, infrastructure needs other than road and drainage maintenance and reconstruction will be limited.

It is assumed that the City Council initially will adopt all fee ordinances currently enforced by the County to ensure a continual flow of existing fee revenues. While this CFA addresses issues of fiscal feasibility, it has not evaluated the need for, or financing of, future capital improvements with the exception of road maintenance and reconstruction. To the extent that the new City is able to build its reserves, it may choose to fund additional capital facilities and improvements, for example, a city hall and/or other community buildings or parks. The **Table 1** cash flow for the new City does not show capital improvements.

## IV. GROWTH AND DEVELOPMENT

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The population within San Martin is estimated at approximately 6,900. Because of restrictions on parcel size and limitations from septic constraints, new development has occurred in the range of five to ten units annually<sup>7</sup> and is expected to continue at a similar rate according to regional projections.<sup>8</sup> The actual number of new units in a given year will vary depending on market conditions, development cycles, and building activity. No changes in current zoning, land use, or infrastructure constraints are assumed as a result of incorporation. The CFA does not assume any significant increase in new commercial development.

At the same time, portions of the community, particularly the community core, are in need of further services and general improvement. Cityhood can provide additional tools to seek redevelopment of the village core. Residents may feel empowered to seek greater remedies or abatement of violations through their new town and administration.

The South County Airport property is within the proposed incorporation area. The airport currently has approximately 160 based aircraft and a basing capacity of 278 aircraft. The draft South County Airport Master Plan<sup>9</sup> proposes an extension of the existing runway from 3,100 feet to 5,000 feet and an increase in aircraft basing capacity to 418 by the year 2022. The draft Master Plan also proposes a second Fixed Base Operator (FBO)<sup>10</sup> leasehold in the future as the number of based aircraft increases. The Plan identifies the acquisition of 332 acres of private property adjacent to the airport to prevent future incompatible development. The Plan has not received final approvals, and its timing is uncertain.

Although incorporation will not give the City any control or jurisdiction over South County Airport or affect the Santa Clara County Airport Land Use Commission safety zones, it will give the City land use authority over the private property surrounding the airport including the property that the County plans to acquire over time to prevent incompatible development. The County and the newly incorporated City will need to work together to prevent incompatible development on this property.

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<sup>7</sup> Based on EPS's review of County Planning Department activity, County response to Planning Department data request, County Planning & Development (Development Services) - Planning Dept., 7/31/07, file: County\_Planning\_Dept5a.doc.

<sup>8</sup> MTC projections for Traffic Analysis Zones generally corresponding to the San Martin area indicate similar levels of future development.

<sup>9</sup> Available at [www.countyairports.org](http://www.countyairports.org).

<sup>10</sup> An "FBO" is a service center at an airport that may be a private enterprise or may be a department of the municipality that the airport serves.